Supreme Court, U.S.
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No.

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**IN THE**
**SUPREME COURT OF THE UNITED STATES**
**OCTOBER TERM, 1998**

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ERIK J. HAMILTON,

Petitioner,

vs.

DOCTOR'S ASSOCIATES, INC.,

Respondent.

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*On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit*

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# PETITION FOR A WRIT OF CERTIORARI

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## QUESTIONS PRESENTED

I. Whether the Federal Arbitration Act preempts general state contract law principles, applicable to all contracts, when an arbitration clause is included.

II. Whether the Federal Arbitration Act authorizes United States district courts to compel arbitration of damage claims pending in previously filed, non-removable, state cases.

## LIST OF PARTIES

The names of all parties to the proceedings in the Court whose judgment is sought to be reviewed here appear in the caption of the case. There are no parent or subsidiary companies of any party to be listed.

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ERIK J. HAMILTON,

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## PETITION FOR A WRIT OF CERTIORARI

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Petitioner, Erik Hamilton, respectfully petitions for a Writ of Certiorari to review the judgment of the United States Court of Appeals for the Second Circuit.

## OPINION BELOW

The opinion below is reported at 150 F.3d 157 (2nd Cir. 1998) and reproduced in the Appendix at pages 1a-15a.

## STATEMENT OF JURISDICTION

The Court of Appeals entered judgment on July 14, 1998. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

## STATUTES INVOLVED

9 U.S.C. § 3.

**§ 3. Stay of proceedings where issue therein referable to arbitration**

If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

9 U.S.C. § 4.

**§ 4. Failure to arbitrate under agreement; petition to United States court having jurisdiction for order to compel arbitration; notice and service thereof; hearing and determination**

A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written

agreement for arbitration may petition any United States district court which, save for such agreement, would have jurisdiction under Title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties, for an order directing that such arbitration proceed in the manner provided for in such agreement. * * *

## STATEMENT OF THE CASE

Erik Hamilton (the franchisee) is a New Jersey citizen who operated a Subway Sandwich franchise shop in New Jersey pursuant to a franchise agreement with Doctor's Associates, Inc. (hereinafter "DAI"), a Florida corporation with its principal office and place of business in Milford, Connecticut.

The Subway Sandwich franchise shop was operated in New Jersey and therefore ostensibly governed by the New Jersey Franchise Act, N.J.S.A. 56:10-1 through 56:10-15.

The New Jersey Supreme Court has previously held that choice of law clauses, applying the law of states other than New Jersey to franchise agreements operated by New Jersey citizens within the State of New Jersey, are void and unenforceable as against the public policy of New Jersey. Instructional Systems, Inc. v. Computer Curriculum Corp., 130 N.J. 323, 614 A.2d 124 (1992). The New Jersey Supreme Court has also previously ruled that choice of forum clauses in New Jersey franchise agreements operated by New Jersey citizens within the State of New Jersey, requiring litigation in states other than New Jersey, are void and unenforceable as against the

public policy of New Jersey. Kubis & Perszyk Associates, Inc. v. Sun Microsystems, Inc., 146 N.J. 176, 68 A.2d 618 (1996).

The Subway Sandwich franchise agreement at issue contained a choice of law clause applying the law of Florida and a choice of forum clause requiring arbitration in Bridgeport, Connecticut.

When a dispute arose about Erik Hamilton's claim that he was fraudulently induced into the franchise agreement by false representations about the past business success of the existing Subway shop he acquired, DAI filed an arbitration demand with the American Arbitration Association in Hartford, Connecticut on December 26, 1996.

On January 22, 1997, Erik Hamilton and Hamilton Williams, Inc. (the corporation through which he operated the Subway franchise) filed suit against DAI and its development agents, William McClain and Michael Stocklin in Middlesex County, New Jersey, alleging common law fraud and violation of the New Jersey Franchise Act. Michael Stocklin shared New Jersey citizenship with Erik Hamilton.

On March 14, 1997, DAI filed a petition to compel arbitration against Erik Hamilton in the United States District Court for Connecticut pursuant to 9 U.S.C. § 4, along with a petition to enjoin Erik Hamilton from prosecution of the New Jersey action against DAI, William McClain and Michael Stocklin.

The franchise agreement also provides that the parties are required to litigate in Connecticut and

waive their right to a trial by jury, if the arbitration clause is unenforceable. The franchise agreement limits damage claims by franchisees to no more than $50,000.00 and excludes claims for punitive or consequential damages, while permitting DAI to prosecute claims for infringement of its trade marks or copyrights or for disclosure of confidential information in excess of $50,000.00. The franchise agreement further imposes a penalty upon the franchisee, for all expenses and attorney's fees incurred by DAI, for any violation of the damage limitation clause.

The franchise agreement was not negotiable. Erik Hamilton was required to sign it as is, or not become a Subway franchisee. Erik Hamilton lost his entire net worth through the operation of the franchise agreement. His only asset is a car valued at $2,000.00, and he still owes the bank $55,000.00 for the loan used to fund the franchise operation.

DAI offered Erik Hamilton $50,000.00 (the amount of the damage limitation clause) to settle his claim before he filed suit in New Jersey. When he declined the $50,000.00 offer, an in-house attorney advised him that DAI would force him into arbitration and keep him tied up in court and/or arbitration for five years. He negotiated with DAI for 11 months before filing his lawsuit. He has insufficient funds to pay as much as $1,000.00 to the American Arbitration Association. Excluding attorney's fees, the costs to Erik Hamilton of arbitrating in Connecticut before the American Arbitration Association is estimated to be $20,000.00 for American Arbitration Association fees, transcripts and the fees of the arbitrators and an

additional $8,000.00 to $12,000.00 for travel and lodging for him, his attorney and witnesses.

The District Court held that diversity jurisdiction exists because DAI did not enforce the $50,000.00 damage limitation clause, that it was not necessary to determine whether New Jersey law applied and that New Jersey law was preempted by the Federal Arbitration Act.

The court below affirmed on July 14, 1998, holding that New Jersey law was preempted by the Federal Arbitration Act, Appendix, p. 10a, and that 9 U.S.C. § 4 permits a United States district court to compel arbitration of damage claims previously pending in a non-removable state case, Appendix, p. 8a.

## REASONS FOR GRANTING THE WRIT

### I. The Petition should be granted because the decision below conflicts with prior opinions of this Court holding that only state laws referable specifically to arbitration contracts are preempted by the Federal Arbitration Act.

Petitioner respectfully submits that the opinion below conflicts with relevant decisions of this Court, and alternatively, decides an important question of federal law that has not been, but should be, settled by this Court. The petition should be granted under Supreme Court Rule 10(c).

Moses H. Cone Memorial Hospital v. Mercury Construction Corp., 460 U.S. 1 (1983) was decided when the question of whether the Federal Arbitration Act, 9 U.S.C. § 1, et seq. (the "FAA") was a federal procedural statute or substantive law was still undecided. One year later, the Court decided Southland Corp. v. Keating, 465 U.S. 1, 21-36 (1984) holding that the FAA is substantive law which applies in both state and federal courts.

Subsequent cases hold that the validity and enforceability of arbitration clauses are determined by general state contract law principles, within the parameters of the federal policy restrictions of the FAA, so long as the state laws apply to contracts generally and were not developed specifically for arbitration contracts. Perry v. Thomas, 482 U.S. 483, 492, n. 9 (1987); Allied-Bruce Terminix Companies, Inc. v. Dobson, 513 U.S. 265, 281 (1995); First Options of Chicago, Inc. v. Kaplan, 514 U.S. 938, 115 S. Ct. 1920, 1924 (1995) and Doctor's Associates, Inc. v. Casarotto, 116 S. Ct. 1562, 1565 (1996).

In Volt Informational Sciences, Inc. v. Leland Stanford, Jr. University, 489 U.S. 468, 474, 477, n. 6, 478 (1989), the court held that the substantive provisions of the FAA (Sections 1 and 2) apply in both state and federal courts, but the procedural provisions (Sections 3 and 4) do not and that the FAA was merely designed to place arbitration agreements "upon the same footing as other contracts." Justices Stevens, Scalia, O'Connor and Thomas dissented in one or more of these cases, while Justice Rehnquist authored Volt Informational Sciences, Inc. v. Board of Trustees of Leland Stanford, Jr. University, 489 U.S.

468 (1989), which used a choice of law clause in the principal contract to apply California procedure to a dispute about enforcing an arbitration clause, concluding that the California statute, which permitted the trial court to stay arbitration pending litigation of non-arbitrable claims, was not preempted by the FAA.

In Allied-Bruce Terminix Companies, Inc. v. Dobson, 513 U.S. 265, 115 S. Ct. 834, 844-45 (1995), Justice Scalia again dissented, stating that he would not dissent in future cases, but stood ready to join four other justices in overruling Southland v. Keating.

Petitioner does not ask this Court to overrule Southland v. Keating. Petitioner does request the Court to limit, however, Southland v. Keating, Perry v. Thomas, Allied-Bruce Terminix Companies, Inc. v. Dobson, Doctor's Associates, Inc. v. Casarotto and First Options of Chicago, Inc. v. Kaplan to their implicit holdings that the FAA does not preempt general state contract law principles applicable to all contracts. Only state laws referable specifically to arbitration contracts are preempted, if inconsistent, by the FAA.

New Jersey has established, by both statute and judicial decision, a strong state policy of protecting New Jersey citizens-franchisees operating franchise shops within New Jersey from the generally more dominant franchisors. The New Jersey Supreme Court has declared choice of law and choice of forum clauses in New Jersey franchise agreements, requiring litigation in other states under the laws of other states, void and unenforceable as against public

policy, as permitted by M/S Bremen v. Zapata Off-Shore Co., 407 U.S. 1 (1972), which was based upon federal question, admiralty, jurisdiction and involved an international contract. Instructional Systems, Inc. v. Computer Curriculum Corp., 130 N.J. 323, 614 A.2d 124 (1992) and Kubis & Perszyk Associates, Inc. v. Sun Microsystems, Inc., 146 N.J. 176, 68 A.2d 618, 623-24 (1996). The New Jersey Franchise Act, N.J.S.A. 56:10-1 through 56:10-15, and New Jersey public policy under the Act apply to all franchise agreements for New Jersey citizens which are operated within New Jersey, not just franchise agreements which contain arbitration clauses. The decision below provides that New Jersey law, applicable to all franchise contracts, not just franchise contracts with arbitration clauses, is preempted by the Federal Arbitration Act and Southland v. Keating. See the Appendix, p. 10a.

Petitioner respectfully submits that the FAA was not intended to preempt general state contract law principles, applicable to all contracts, not just contracts containing arbitration clauses, and that the decisions of this Court do not so provide.

The opinion below precludes the states from adopting state laws to protect their citizens from oppressive agreements even when such state laws apply to all contracts generally, and not just to arbitration contracts. Petitioner respectfully submits that the FAA was not intended to override general state substantive law principles in this fashion.

A state law which precludes choice of law and forum selection clauses for resolution of claims under

the New Jersey Franchise Act, which applies uniformly to both out-of-state litigation and arbitration proceedings, does not conflict with the principles of the Federal Arbitration Act, which merely require that arbitration contracts be placed upon "the same footing as other contracts." Volt Informational Sciences, Inc. v. Leland Stanford, Jr. University, 489 U.S. 468, 474 (1989).

## II. The Petition should be granted because the enforcement sections of the Federal Arbitration Act (9 U.S.C. §§ 3, 4) do not provide statutory authority to United States district courts to compel arbitration of damage claims pending in previously filed, non-removable, state cases.

Petitioner respectfully submits that the Second Circuit opinion decided an important question of federal law that has not been, but should be, settled by this Court. The Petition should be granted under Supreme Court Rule 10(c).

The non-removable New Jersey state action by Erik Hamilton against DAI, William McClain and Michael Stocklin was pending when DAI filed its federal petition to compel arbitration in the United States District Court for Connecticut, under 9 U.S.C. § 4, seeking to compel arbitration of the damage claims pending between Hamilton and DAI in the New Jersey state case and an injunction barring further prosecution of the state case against any of the state defendants.

A motion to stay litigation pending arbitration under 9 U.S.C. § 3 may be filed only in the case to be stayed. Even if diversity jurisdiction of DAI's Connecticut federal petition to compel arbitration exists, the Connecticut federal court did not have authority under 9 U.S.C. § 3 to stay the pending New Jersey state action. Moses H. Cone Memorial Hospital v. Mercury Construction Corp., 460 U.S. 1, 25, n. 32 (1983), provides "Section 3 likewise limits the federal courts to the extent that a federal court cannot stay a suit pending before it unless there is such a suit in existence."

DAI has used 9 U.S.C. § 4 to accomplish something prohibited by 9 U.S.C. § 3 – the use of one court to stay damage claims pending in another court. After compelling arbitration of the claims between Erik Hamilton and DAI, the Connecticut Federal Court enjoined the entire New Jersey state action. This Court previously held that the decision to stay litigation among the nonarbitrating parties pending the outcome of the arbitration should be left to the federal district court, or the state trial court under applicable state procedural rules, as a matter of the respective courts' discretion to control their dockets. Moses H. Cone, 460 U.S. 1, 20, n. 23 (1983). This Court also previously declined to determine whether the Anti-Injunction Act, 28 U.S.C. § 2283 barred a federal court from staying (or enjoining) a state court suit pending arbitration. Moses H. Cone, 460 U.S. 1, 25, n. 32 (1983). The decision below affirmed the Connecticut Federal Court injunction barring the New Jersey state court from proceeding with litigation between the nonarbitrating parties, using

Section 4, and the injunction, to accomplish what is prohibited by Section 3.

Petitioner respectfully submits that Sections 3 and 4 of the FAA must be read together and that Section 4 does not permit a federal district court to compel arbitration of damage claims previously pending in a non-removable state action, even if diversity jurisdiction exists for the federal petition to compel arbitration. See, however, Whiteside v. Teltech Corp., 940 F.2d 99 (4th Cir. 1991) which held that a federal district court was obligated to determine the arbitrability of damage claims in a pending state action, although the court did not consider the argument advanced here.

9 U.S.C. § 4 permits a party to petition any United States district court which, save for the arbitration agreement * * * "would have jurisdiction under Title 28, in a civil action * * * of the subject matter of a suit arising out of the controversy of the parties * * *." Unless Section 4 is describing a hypothetical action by Erik Hamilton against only DAI, instead of the actual pending state suit by Erik Hamilton against DAI, McClain and Stocklin, the Section 4 requirements of federal jurisdiction of the underlying dispute have not been met here. It makes little sense to base the statutory authority of Section 4 upon a hypothetical lawsuit instead of the real, pending state action. The "would have jurisdiction under Title 28" language in 9 U.S.C. § 4 was intended to apply when the suit claiming damages had not yet been filed. Once the damage lawsuit is filed, motions to enforce the arbitration agreement should be filed there, if possible.

At the time the Connecticut federal action was filed, the Connecticut Federal District Court would not have had jurisdiction under Title 28, but for the arbitration clause, of the subject matter of a suit arising out of the controversy between Erik Hamilton and DAI, because that suit was already pending in the non-removable New Jersey state action. DAI could have determined the validity and enforceability of the arbitration clause in the New Jersey state action under the New Jersey Uniform Arbitration Act.

Section 4 of the FAA does not permit what Section 3 prohibits. "Section 4 provides for an order compelling arbitration only when the federal district court would have jurisdiction over a suit on the underlying dispute." Moses H. Cone, 460 U.S. 1, 25, n. 32 (1983). Here the suit on the underlying dispute was already pending in a non-removable state case when the federal petition was filed. The FAA was not intended to permit one court to compel arbitration of damage claims pending in another court.

This plain meaning interpretative approach is wholly consistent with legislative intent. Congress clearly intended that federal jurisdiction not be affected by the Federal Arbitration Act. Both the first (1921) and the second (1922) drafts of the Federal Arbitration Act contained a section enlarging diversity jurisdiction. 46 A.B.A. Rep. 359; 47 A.B.A. Rep. 315. This section was deleted by the Senate Judiciary Committee before the legislation was enacted. 49 A.B.A. Rep. 284 (1924). Specifically, Senator Walsh, Committee Chairman, stated that the reason for deleting that section was "the reluctance on

the part of Congress to increase the jurisdiction of the federal court." Id.

The Second Circuit, however, has equated diversity jurisdiction of the petition to compel arbitration (not jurisdiction of the underlying dispute) with statutory authority to compel arbitration of damage claims pending in another court. Doctor's Associates, Inc. v. Distajo, et al., 66 F.3d 438, 444-446 (2nd Cir. 1995). The opinion below relies upon Doctor's Associates, Inc. v. Distajo, concluding that diversity jurisdiction of the federal petition to compel arbitration equates with statutory authority (which requires jurisdiction of the underlying dispute) to compel arbitration of damage claims pending in another court. New Jersey law, applicable to all franchise contracts, not just arbitration agreements, however, voids the choice of law and forum selection clauses which DAI relies upon to claim that "save for" the arbitration clause, the Connecticut Federal Court would have had jurisdiction and venue of the underlying dispute. Doctor's Associates, Inc. v. Stuart, 85 F.3d 975, 978, 983 (2nd Cir. 1996).

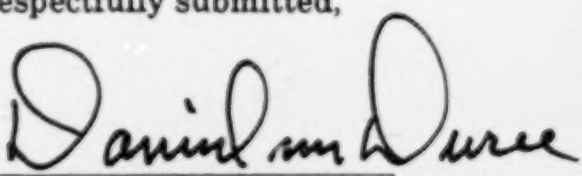
Congress intended that the substantive parts of the FAA (Sections 1 and 2) be enforced by the state courts when they have jurisdiction of the underlying damage claims. Moses H. Cone, 460 U.S. 1, 25, n. 32 (1983), "nevertheless, although enforcement of the Act is left in large part to the state courts, it nevertheless represents federal policy to be vindicated by the federal courts where otherwise appropriate." Under the decision below, the state courts will rarely have the opportunity to apply the FAA to underlying damage claims exclusively within their jurisdiction.

Instead, the parties seeking arbitration will tend to file separate, original, federal actions to determine the arbitrability of pending state damage claims, requiring the federal courts to determine issues governed largely by state law.

## CONCLUSION

For the reasons stated, the Petition for a Writ of Certiorari should be granted.

Respectfully submitted,



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# APPENDIX

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

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August Term, 1997

(Argued May 21, 1998 Decided July 14, 1998)

Docket No. 97-9271

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DOCTOR'S ASSOCIATES, INC.,

*Plaintiff-Appellee,*

—v.—

ERIK J. HAMILTON,

*Defendant-Appellant.*

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Before:

MESKILL and KEARSE, *Circuit Judges,*
and TELESCA, *District Judge.**

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Appeal from an order of the United States District Court for the District of Connecticut, Dorsey, *J.*, compelling arbi-

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* Honorable Michael A. Telesca, United States District Judge for the Western District of New York, sitting by designation.

tration and enjoining defendant-appellant Hamilton from prosecuting action in state court.

Affirmed.

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DAVID M. DUREE, Reinert & Duree, St. Louis, MO (Nicholas Wocl, Tooher, Puzzuoli & Wocl, Stamford, CT, of counsel), *for Appellant.*

EDWARD WOOD DUNHAM, Wiggin & Dana, New Haven, CT, *for Appellee.*

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MESKILL, *Circuit Judge*:

Defendant-appellant Erik J. Hamilton (Hamilton) appeals from an order of the United States District Court for the District of Connecticut, Dorsey, *J.*, compelling arbitration with, and enjoining him from prosecuting a New Jersey lawsuit he filed against, plaintiff-appellee Doctor's Associates, Inc. (DAI), the franchisor of "Subway" sandwich shops. Hamilton challenges the district court's exercise of jurisdiction over this action and the court's failure to apply New Jersey law to resolve Hamilton's challenge to the franchise agreement's arbitral forum selection clause and his unconscionability defense to the arbitration agreement. For the reasons set forth below, we affirm the decision of the district court.

## BACKGROUND

DAI is a Florida corporation with its principal place of business in Fort Lauderdale, Florida and an office in Milford, Connecticut. In June 1995 Hamilton entered into a franchise agreement (the "Agreement") with DAI, permitting him to operate a Subway shop in Voorhees, New Jersey. Several provisions of the Agreement are relevant to the issues on appeal. Paragraph 10(c) of the Agreement contains an arbitration clause (and an arbitral forum selection clause), which states:

> Any dispute or claim arising out of or relating to this Agreement not settled by the parties . . . in accordance with the terms of this Agreement is to be submitted directly to arbitration, shall be settled in accordance with the Expedited Procedures of the Commercial Arbitration Rules of the American Arbitration Association at a hearing to be held at Bridgeport, Connecticut. Judgment upon an award rendered by the Arbitrator may be entered in any court having jurisdiction. The commencement of . . . arbitration proceedings by an aggrieved party to settle any such dispute or claim is a condition precedent to the commencement of legal action by either party, except as specifically provided in this Agreement.

Paragraph 10(b) of the Agreement further provides that the Federal Arbitration Act ("FAA" or "the Act"), 9 U.S.C. §§ 1-16, applies to all claims arising out of, among other things, "applicable state franchise disclosure or franchise relationship statutes." The Agreement, under Paragraph 10(d), also provides, in pertinent part, that "the total of all permissible claims arising under or relating to this Agreement, including the breach thereof, for damages made by either party against the other shall not exceed $50,000" ("$50,000 limit" or "liability cap"). Finally, Paragraph 13

contains a choice-of-law provision, which provides that the "Agreement shall be governed by and construed in accordance with the laws of the State of Florida without reference to the body of laws governing conflicts of law."

On December 26, 1996 DAI filed a demand for arbitration with the American Arbitration Association (AAA) to resolve a dispute with Hamilton who claimed he had been fraudulently induced to enter into the Agreement. DAI requested a declaratory judgment that it had not committed fraud and that "any failure of [Hamilton's] business and loss of money was entirely [Hamilton's] responsibility."

On January 22, 1997 Hamilton filed a lawsuit against DAI in the Superior Court of New Jersey (the "New Jersey suit"), alleging that DAI fraudulently induced him to enter into the Agreement and violated the New Jersey Franchise Practices Act. *See* N.J. Stat. Ann. §§ 56:10-1 to 56:10-15 (West 1989). In addition to DAI, Hamilton named as defendants Michael Stocklin and William McClain, both of whom were development agents for DAI. At the time Hamilton filed his complaint, Stocklin was a New Jersey resident. Hamilton alleged that Stocklin and McClain, in conjunction with DAI, made various fraudulent misrepresentations to him concerning the past sales and other aspects of the store he eventually operated. Hamilton sought over $1 million in actual and punitive damages in addition to attorney's fees.

On March 14, 1997 DAI filed this petition to compel arbitration of the dispute between it and Hamilton and moved to enjoin Hamilton from prosecuting the New Jersey suit. Initially, on May 21, 1997 the district court rejected all of Hamilton's defenses to DAI's petition to compel arbitration. Nonetheless, the court denied, without prejudice to renewal, DAI's petition and motion because it believed Hamilton had alleged that he was fraudulently induced into agreeing to the

arbitration clause of the Agreement. The district court held that this issue had to be resolved by the state court before a stay would issue. On September 18, 1997, however, after receiving supplemental briefing on the issue, the district court determined that Hamilton's "allegations of fraud in the inducement relate[d] to the franchise agreement as a whole, rather than the arbitration clause." The court therefore concluded that Hamilton's fraud in the inducement claim should be resolved by the arbitrator and it granted DAI's petition to compel arbitration and enjoined Hamilton from prosecuting the New Jersey suit.

This appeal followed.

## DISCUSSION

On appeal, Hamilton contends that the district court erred in compelling arbitration because it had no subject matter jurisdiction. According to Hamilton, DAI did not satisfy the requirement for diversity jurisdiction because the Agreement limited damages to $50,000, and Section 4 of the Act does not provide a "federal statutory cause of action permitting the federal courts to determine the arbitrability of pending, non-removable, state damage claims." Hamilton also contends that the district court erred by failing to apply New Jersey law to determine the enforceability of the arbitral forum selection clause and to resolve his unconscionability defense to the arbitration agreement. Hamilton argues that the Agreement's choice of law provision that designated Florida law as the law governing the parties' relationship is void because it conflicts with New Jersey law. These arguments lack merit.

When reviewing a district court's decision regarding subject matter jurisdiction, we review factual findings for clear error and legal conclusions *de novo*. *See Conntech Dev. Co. v. University of Connecticut Educ. Properties*, 102 F.3d 677,

681 (2d Cir. 1996). We review a district court's decision to compel arbitration *de novo*. *See Doctor's Assocs.* v. *Distajo*, 66 F.3d 438, 444 (2d Cir. 1995), *cert. denied*, 517 U.S. 1120 (1996) (*Distajo I*).

I. *Subject Matter Jurisdiction*

A. *Amount-in-Controversy Requirement*

Hamilton argues that the district court erred in deciding that diversity jurisdiction existed. According to Hamilton, Paragraph 10(d) of the Agreement limits damages to $50,000, which is less than the $75,000 amount-in-controversy requirement. *See* 28 U.S.C. § 1332. The district court rejected this argument, observing that Hamilton, in the New Jersey suit, "seeks over $1,000,000 in damages . . . well over the $75,000 [jurisdictional] minimum. [Hamilton] has ignored the cap on damages set forth in the franchise agreement, and as a result, DAI is forced to defend a claim for over $1,000,000." The district court concluded that "[t]he damages sought in the state action . . . is the amount in controversy." We agree.

DAI's petition to compel arbitration states that the amount in controversy exceeds $75,000. "[T]he sum claimed by the plaintiff [DAI] controls if the claim is apparently made in good faith. It must appear *to a legal certainty* that the claim is really for less than the jurisdictional amount to justify a dismissal." *A.F.A. Tours* v. *Whitchurch*, 937 F.2d 82, 87 (2d Cir. 1991) (citation and internal quotation marks omitted). In the context of a petition to compel arbitration, we have advised district courts to "look through to the possible award resulting from the desired arbitration, since the petition to compel arbitration is only the initial step in a litigation which seeks as its goal a judgment affirming the award." *Davenport* v. *Proctor & Gamble Mfg. Co.*, 241 F.2d 511, 514 (2d Cir.

1957); *see also Jumara* v. *State Farm Ins. Co.*, 55 F.3d 873, 877 (3d Cir. 1995) ("[T]he amount in controversy in a petition to compel arbitration . . . is determined by the underlying cause of action that would be arbitrated."); *Webb* v. *Investacorp*, 89 F.3d 252, 257 n.1 (5th Cir. 1996) (per curiam) (noting that the amount in controversy is the difference "between winning and losing the underlying arbitration").

Here, the underlying dispute to be arbitrated is Hamilton's claim that he was fraudulently induced to enter into the Agreement with DAI, that DAI violated the New Jersey Franchise Practices Act, and that DAI bears the financial responsibility for his losses. In the New Jersey suit, Hamilton, apparently contesting the validity of the liability cap, seeks in excess of $1 million in damages, well over the $75,000 jurisdictional minimum. Should the parties proceed to arbitration and DAI prevail, DAI would have defeated a claim in excess of $1 million in damages. Therefore, the district court properly concluded that notwithstanding the liability cap in the contract, the amount-in-controversy requirement had been met as it could not be said to a "legal certainty" that the award resulting from Hamilton's claims would not exceed the $75,000 jurisdictional minimum.

We dispose of Hamilton's remaining argument that the district court improperly declined to determine the validity of the liability cap before holding that the jurisdictional minimum of $75,000 was satisfied. As the district court properly concluded, Hamilton's request in the New Jersey suit for recovery in excess of the liability cap was the decisive basis for determining the amount in controversy.

B. *Diversity of Citizenship*

Hamilton claims that the district court erred in compelling arbitration "because 9 U.S.C. § 4 does not provide a federal statutory cause of action to determine the arbitrability of damage claims pending in a previously filed, non-removable[ ] state case." In other words, Hamilton argues that there cannot be diversity jurisdiction in DAI's federal lawsuit because of the lack of complete diversity of citizenship among the parties in the New Jersey suit. The district court rejected Hamilton's argument, concluding that diversity jurisdiction is determined by reference to the parties to the petition to compel arbitration, not the parties to the New Jersey suit. We agree.

Section 4 of the Act provides that "[a] party aggrieved by the alleged failure . . . of another to arbitrate . . . may petition any United States district court which . . . would have jurisdiction . . . of the subject matter of a suit *arising out of the controversy between the parties*." 9 U.S.C. § 4 (emphasis added). In *Distajo I*, we interpreted "controversy between the parties" to mean the dispute between the parties to the petition to compel arbitration. *Distajo I*, 66 F.3d at 445. We reasoned that "[a]s with any federal action, diversity of citizenship is determined by reference to the parties named in the proceedings before the district court, as well as any indispensable parties who must be joined pursuant to Rule 19 of the Federal Rules of Civil Procedure." *Id.* We declined to determine diversity of citizenship by reference to the parties named in a parallel state action because "a party resisting arbitration could defeat federal jurisdiction simply by suing someone from the same state, plus the party seeking to compel arbitration, in a separate state lawsuit." *Id.*

Here it is clear from the pleadings that the parties to this petition, Hamilton, a New Jersey citizen, and DAI, a Florida

corporation, are diverse. Furthermore, Hamilton makes no claim, nor do we perceive any basis for a claim, that either McClain or Stocklin, defendants in the parallel state action, are indispensable parties to the petition to compel arbitration. *See* Fed. R. Civ. P. 19; *Distajo I*, 66 F.3d at 446.

In sum, we are satisfied that the district court had diversity jurisdiction over this action and that Hamilton's jurisdictional challenges are without merit.

II. *Application of New Jersey Law*

Hamilton argues that the district court erred by failing to apply New Jersey law to determine the enforceability of the Agreement's arbitral forum selection clause and to review his unconscionability defense. Hamilton contends that the arbitral forum selection clause is void and unenforceable as against the public policy of New Jersey and that the arbitration clause is unconscionable to the extent that it requires Hamilton to travel to Connecticut to arbitrate and to share the costs of arbitration. Hamilton also argues that the Agreement's choice of law clause designating Florida law as the law governing the parties' relationship is void because it contravenes the public policy behind the New Jersey franchise law. In support of his challenge to the forum selection clause, Hamilton relies on *Kubis & Perszyk Assocs.* v. *Sun Microsystems*, 146 N.J. 176, 680 A.2d 618 (1996), in which the New Jersey Supreme Court held that a forum selection clause in a franchise agreement which designated an out-of-state *judicial* forum was presumptively invalid under the state's franchise protection act. *Kubis*, 146 N.J. at 195, 680 A.2d at 627.

The district court rejected these arguments. It distinguished *Kubis* as dealing with a clause designating a judicial forum, not an arbitral forum. The court then held that to the extent that *Kubis* applied to arbitral forum selection clauses, it was

preempted by the FAA. As expressed in *Southland Corp.* v. *Keating*, 465 U.S. 1 (1984), the Act "foreclose[d] state legislative attempts to undercut the enforceability of arbitration agreements." *Id.* at 16. According to the district court, *Kubis* did not set forth a defense to an arbitration agreement "that exists [at] law or in equity for the revocation of any contract." (quoting *Southland*, 465 U.S. at 16 n.11.) (internal quotation marks omitted). Furthermore, the district court rejected Hamilton's unconscionability defense to arbitration citing our holding in *Doctor's Assocs.* v. *Stuart*, 85 F.3d 975 (2d Cir. 1996), where we rejected an unconscionability argument nearly identical to Hamilton's. *Id.* at 980-81. The district court also concluded that Hamilton was obligated to arbitrate his disputes with DAI regardless of the enforceability of the choice of law provision. On review, we affirm the district court's conclusions.

A. *Standard*

Any analysis of a party's challenge to the enforcement of an arbitration agreement must begin by recognizing the FAA's strong policy in favor of rigorously enforcing arbitration agreements. *See Perry* v. *Thomas*, 482 U.S. 483, 490 (1987). The Supreme Court has observed that " '[t]he preeminent concern of Congress in passing the Act was to enforce private agreements into which parties had entered.' " *Id.* (quoting *Dean Witter Reynolds* v. *Byrd*, 470 U.S. 213, 221 (1985)) (alteration in original).

This policy favoring arbitration is reflected in the narrow role played by state law in FAA jurisprudence. The Supreme Court has declared that the FAA preempts all state laws that impermissibly burden arbitration agreements. *See Southland*, 465 U.S. at 10-11. In *Southland*, the Supreme Court reversed the California Supreme Court's holding that claims under California's franchise act were not subject to arbitration

under the parties' arbitration agreement. The Supreme Court held that the FAA preempted the California act: "In enacting § 2 of the federal Act, Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration." *Id.* at 10; *see also Mastrobuono* v. *Shearson Lehman Hutton*, 514 U.S. 52, 56 (1995).

Section 2 of the FAA provides that arbitration agreements subject to the FAA "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. The Supreme Court has explained the significance of this section:

> [T]he text of § 2 provides the touchstone for choosing between state-law principles and the princi ples of federal common law envisioned by the passage of that statute: An agreement to arbitrate is valid, irrevocable, and enforceable, *as a matter of federal law*, . . . "save upon such grounds as exist at law or in equity for the revocation of *any* contract." 9 U.S.C. § 2 (emphasis added). Thus state law, whether of legislative or judicial origin, is applicable *if* that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally.

*Perry*, 482 U.S. at 492 n.9 (citation omitted). In short, the Court has declared that only "generally applicable contract defenses, such as fraud, duress, or unconscionability, may be applied to invalidate arbitration agreements without contravening § 2." *Doctor's Assocs.* v. *Casarotto*, 517 U.S. 681, 687 (1996). In addition, the Supreme Court has found "nothing in the Act indicating that the broad principle of enforceability [of arbitration agreements] is subject to any additional limitations under state law." *Southland*, 465 U.S. at 11.

In the light of these principles, we examine Hamilton's challenges to the enforceability of the Agreement's arbitral forum selection and arbitration clauses.

B. *Analysis*

1. *Arbitral Forum Selection Clause*

Hamilton contends the district court erroneously failed to apply New Jersey law to determine the enforceability of the Agreement's arbitral forum selection clause. Despite the clear language in *Southland*, Hamilton urges us to rely on *Kubis & Perszyk Assocs.* v. *Sun Microsystems*, 146 N.J. 176, 680 A.2d 618 (1996), to invalidate the Agreement's arbitral forum selection clause. Recognizing that state law may affect the validity and enforceability of arbitration to the extent that the state law applies to "the revocation of *any* contract," 9 U.S.C. § 2 (emphasis added), Hamilton maintains that the rule set forth in *Kubis* applies to all contracts, including the Agreement here.

We disagree. *Kubis* did not establish a "generally applicable" contract defense that applies to "any" contract; it invalidated a franchise agreement's forum selection clause under the New Jersey Franchise Practices Act because it required the franchisee to sue in another jurisdiction. The *Kubis* decision applies to one sort of contract provision (forum selection) in only one type of contract (a franchise agreement). Therefore, to the extent that *Kubis* can be read to invalidate arbitral forum selection clauses in franchise agreements, it is preempted by the FAA. *See Management Recruiters Int'l* v. *Bloor*, 129 F.3d 851, 856 (6th Cir. 1997) (if the Washington Franchise Investment Protection Act "imposed an absolute requirement of in-state arbitration notwithstanding the parties' agreement to arbitrate [elsewhere], its validity would be in serious doubt as a result of

the preemptive effect of the FAA"); *Stirlen* v. *Supercuts*, 51 Cal. App.4th 1519, 1543, 60 Cal. Rptr.2d 138, 153 (Cal. Ct. App. 1997) (recognizing that state statutes conflicting with the pro-arbitration policy of the FAA will be preempted).

2. *Unconscionability*

Hamilton argues that the arbitration clause of the Agreement is unconscionable because of the high costs and prejudice involved in arbitrating. According to Hamilton, he is required to travel to Connecticut to pursue his New Jersey franchise act claims and to share the costs of arbitrating before the AAA. Hamilton estimates that his arbitration fees for arbitrating the claims in his New Jersey suit will total between $28,000 and $32,000. He also argues that the AAA is biased in favor of DAI because it relies on DAI for repeat business.

In *Doctor's Assocs.* v. *Stuart*, 85 F.3d 975 (2d Cir. 1996), we rejected an Illinois franchisee's advancement of the identical arguments made here by Hamilton. We concluded that there was nothing unconscionable about the arbitration clause because it clearly explained both the parties' responsibility for their own costs, which the franchisee was free to investigate before entering into the agreement, and that arbitration would take place in Connecticut. *Id.* at 980-81. The Agreement here is equally clear on both issues. In addition, like Hamilton, the franchisee in *Stuart* failed to present any evidence of the AAA's bias in favor of DAI. Because the Agreement here contains an arbitration clause similar to the one in *Stuart* and because Hamilton does not contest receiving notice of that clause, we are satisfied that the arbitration clause is not unconscionable.

Hamilton, however, argues that the district court failed to consult New Jersey law in deciding whether the arbitration

clause was unconscionable. *See Cassarotto*, 517 U.S. at 687 (State law supporting "generally applicable contract defenses, such as . . . unconscionability, may be applied to invalidate arbitration agreements without contravening § 2."); *Progressive Casualty Ins. Co.* v. *C.A. Reaseguradora Nacional De Venezuela*, 991 F.2d 42, 46 (2d Cir. 1993) (Section 2 of the Act "preserves general principles of state contract law as rules of decision on whether the parties have entered into an agreement to arbitrate." (internal quotation marks and citation omitted)). According to Hamilton, the district court instead relied exclusively on *Stuart*, which was not grounded in New Jersey law. *See Stuart*, 85 F.3d at 980 ("The purpose of the unconscionability doctrine is to prevent unfair surprise and oppression." (citations and internal quotation marks omitted)).

Without reaching the merits of Hamilton's contention, we conclude that he has waived this argument. He failed to bring New Jersey law on unconscionability to the attention of the district court or to argue that section 2 of the Act preserved general principles of state law as rules of decision. Even on appeal, Hamilton cites no New Jersey law undermining the conclusion reached in *Stuart*, nor does he make any argument that New Jersey's standard regarding unconscionability is in any material respect different from the law applied in *Stuart*.

Hamilton's final argument is that the Agreement's choice of law provision designating Florida law as the law governing the parties' relationship is void because it conflicts with New Jersey franchise law. We need not decide this question as we have already concluded that none of Hamilton's arguments based on New Jersey law has merit and no question of Florida law is presented on appeal.

In sum, we affirm the district court's rejection of Hamilton's unconscionability and choice of law arguments.

## CONCLUSION

Diversity jurisdiction exists over this action. We affirm the district court's order compelling arbitration and enjoining Hamilton from prosecuting his New Jersey suit.

Supreme Court, U.S.
FILED
98 630 OCT 9 1998

No. 98-

# IN THE SUPREME COURT OF THE UNITED STATES OCTOBER TERM, 1998

ERIK J. HAMILTON,

Petitioner,

vs.

DOCTOR'S ASSOCIATES, INC.,

Respondent.

*On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit*

## SUPPLEMENTAL APPENDIX TO THE PETITION FOR A WRIT OF CERTIORARI

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UNITED STATES DISTRICT COURT
DISTRICT OF CONNECTICUT

| | | |
|---|---|---|
| DOCTOR'S ASSOCIATES, INC., Plaintiff, | : | |
| -vs- | : | Civil No. 3:97cv00459 |
| ERIK J. HAMILTON, Defendant. | : | (PCD) |

**RULING ON PETITION TO COMPEL ARBITRATION AND MOTION FOR INJUNCTIVE RELIEF**

Plaintiff Doctor's Associates, Inc. ("DAI") moves to compel arbitration of its dispute with Defendant Erik J. Hamilton ("Defendant") pursuant to 9 U.S.C. § 4 and for an injunction enjoining Defendant from prosecuting the action currently pending in the New Jersey state court. For the following reasons, DAI's petition to compel arbitration is DENIED. DAI's motion for an injunction is DENIED.

## *I. BACKGROUND*

DAI is the national franchisor of Subway sandwich shops and is a Florida corporation. Defendant is a Subway franchisee residing in New Jersey. On or about June 27, 1995, DAI entered into a standard written franchise agreement with Defendant, permitting him to operate a Subway shop in New Jersey. The agreement contains an arbitration clause (¶ 10c), which provides:

> Any dispute or claim arising out of or relating to the Agreement not settled by the parties . . . in accordance with the

terms of this Agreement is to be submitted directly to arbitration, shall be settled in accordance with the Expedited procedures of the Commercial Arbitration Rules of the American Arbitration Association at a hearing to be held at Bridgeport, Connecticut. Judgment upon an award rendered by the Arbitrator may be entered in any court having jurisdiction. The commencement of . . . arbitration proceedings by an aggrieved party to settle any such dispute or claim is a condition precedent to the commencement of legal action by either party, except as specifically provided in the Agreement.[1]

Paragraph 10(b) of the agreement provides:

The parties hereby agree that the Federal Arbitration Act shall apply to all disputes and claims arising out of or relating to the Agreement, including the breach thereof, and including any alleged violations of the Racketeering Influenced and Corrupt Organizations Act (RICO), applicable state franchise disclosure or franchise relationship statutes, including but not limited to unfair trade practice statutes or similar

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[1] Defendant does not dispute that his state court claims fall within the scope of the arbitration clause.

> statutes, and that the business which is the subject of this Agreement is engaged in interstate commerce.

Disputes arose and DAI filed a demand for arbitration with the American Arbitration Association ("AAA") on or about January 8, 1997. DAI requested declaratory judgment that it did not fraudulently induce Defendant to enter into the franchise agreement and that "any failure of Defendant's business and loss of money was entirely the responsibility of [Defendant]." Arbitration Demand. On or about January 22, 1997, Defendant filed a lawsuit against DAI and certain DAI employees in the Superior Court of New Jersey, County of Middlesex, Case No. L-847-97. Defendant alleges in his state court complaint that he was fraudulently induced to enter into the franchise agreement and that certain actions taken by DAI under the franchise agreement violate the New Jersey franchise protection statute.[2] DAI seeks to compel arbitration of that dispute and an order enjoining Defendant from prosecuting that action.

Defendant opposes DAI's petition alleging that: (1) there is not subject matter jurisdiction; (2) the clause requiring arbitration in Connecticut is void and unenforceable under the law of New Jersey (the law Defendant claims applies) or Florida (the law

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[2] DAI did not demand arbitration of Defendant's claim that DAI violated the New Jersey franchise act, presumably because DAI filed its demand before Defendant filed his complaint, and therefore DAI was unaware of the claim.

chosen in the franchise agreement); (3) the choice of law clause designating Florida law is void and unenforceable as against public policy because it conflicts with the New Jersey franchise act; and (4) the arbitration clause requiring the parties to share the costs of arbitration conducted in Connecticut is void and unenforceable as it is unconscionable and is a violation of Defendant's due process rights. The parties waived a hearing on this matter.

## *II. DISCUSSION*

### *A. Subject Matter Jurisdiction*

Pursuant to § 4 of the Federal Arbitration Act ("FAA"), district courts only have jurisdiction to hear petitions to compel arbitration if the court "would have jurisdiction under Title 28, in a civil action . . . of the subject matter of a suit arising out of the controversy between the parties . . . ." 9 U.S.C. § 4. Accordingly, "there must be diversity of citizenship or some other independent basis for federal jurisdiction before the [arbitration] order can issue." Doctor's Associates, Inc. v. Distajo, 66 F.3d 438, 444 (2d Cir. 1995), cert. denied, 116 S. Ct. 1352 (1996) (citation omitted). DAI alleges diversity jurisdiction. 28 U.S.C. § 1332. Defendant contests diversity jurisdiction on the basis that the amount in controversy does not exceed the sum or value of $75,000 because the franchise agreement sets a cap on the amount of damages recoverable from claims arising under or relating to the franchise agreement.[3]

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[3] Paragraph 10(d) of the franchise agreement provides:

DAI, having invoked federal jurisdiction, has the burden of proving the requisite amount in controversy. United Food Local 919 v. Centermark Properties, 30 F.3d 298, 301 (2d Cir. 1994); R.G. Barry Corp. v. Mushroom Makes, Inc., 612 F.2d 651, 655 (2d Cir. 1979).

"[D]iversity jurisdiction is determined by reference to the parties named in the proceeding before the district court." Distajo, 66 F.3d at 445. DAI's petition to compel arbitration states that the amount in controversy exceeds $75,000, and "'the sum claimed by the plaintiff [DAI] controls if the claim is apparently made in good faith. It must appear to a legal certainty that the claim is really less than the jurisdictional amount to justify a dismissal.'" A.F.A. Tours, Inc. v. Whitchurch, 937 F.2d 82, 87 (2d Cir. 1991) (quotation omitted) (emphasis in original).

"[T]he amount in controversy in a petition to compel arbitration . . . is determined by the underlying cause of action that would be arbitrated." Jumara v. State Farm Ins. Co., 55 F.3d 873, 877 (3rd Cir. 1995). The court should look at the "possible award resulting from the desired arbitration, since the petition to compel is only the first step in litigation which seeks as its goal a judgment

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The parties agree that the total of all permissible claims arising under or relating to this Agreement, including the breach thereof, for damages made by either party against the other shall not exceed $50,000, as adjusted for inflation annually . . . . [N]either party shall make a claim against the other for punitive or consequential damages nor seek multiple forms of damages of any kind with respect to any claim or cause of action.

affirming an award." Davenport v. Procter & Gamble MFG. Co., 241 F.2d 511, 514 (2d Cir. 1957). The amount in controversy is the difference "between winning and losing the underlying arbitration. . . ." Webb v. Investacorp, Inc., 89 F.2d 252, 257, n. 1 (5th Cir. 1996).

The underlying dispute to be arbitrated, as set forth in DAI's Demand for Arbitration, is whether DAI fraudulently induced Defendant to enter into the franchise agreement and whether Defendant's losses were the responsibility of Defendant or DAI. "[T]he amount in controversy, in an action for declaratory. . . relief, is the value of the right to be protected or the extent of the injury to be prevented." Webb, 89 F.3d at 256 (quotation omitted). Accord: Hunt v. Washington State Apple Advertising Comm'n, 432 U.S. 333, 347 (1977) ("[i]n actions seeking declaratory or injunctive relief it is well established that the amount in controversy is measured by the value of the object of the litigation . . .").

Defendant seeks monetary damages in state court and that amount is the "injury to be prevented" in the arbitration. As such, Defendant's state court complaint provides a basis for ascertaining the amount in controversy in DAI's Petition to Compel Arbitration. Defendant seeks over $1,000,000 in damages in his state court action – well over the $75,000 minimum. Defendant has ignored the cap on damages set forth in the franchise agreement, and as a result, DAI is forced to defend a claim for over

$1,000,000.[4] If DAI wins in arbitration and successfully enjoins Defendant here it will have eliminated a damage exposure of over $1,000,000. The damages sought in the state action is the "injury to be prevented" in the arbitration – that is the amount in controversy. Defendant's assertion that either ¶ 10(d) is valid and there is no diversity jurisdiction or ¶ 10(d) is invalid and the entire agreement is unenforceable, is without merit.[5] There is subject matter jurisdiction over DAI's petition.

### *B. Forum Selection Clause*

Defendant alleges that the "forum selection clause" requiring disputes to be arbitrated in Bridgeport, Connecticut is void and unenforceable as against the public policy of New Jersey. Defendant cites Kubis v. Perszyk Associates, Inc. v. Sun Microsystems, Inc., 146 N.J. 176, 680 A.2d 618 (N.J. 1996).

Assuming the New Jersey franchise act applies, Defendant's position is unpersuasive. In Kubis, the New Jersey Supreme Court held that a forum selection clause in a franchise agreement designating

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[4] DAI, in fact, has exercised its right not to enforce that provision of the agreement and so notified Defendant on April 22, 1997. Paragraph 11(c) provides that any portion of the agreement "shall be deemed not to be a part of this Agreement . . . upon the Franchisee's receipt of notice of nonenforcement from the Company."

[5] If this provision is found to be invalid, the remainder of the agreement remains in full force, including the arbitration clause. See Paragraph 11(c).

a judicial forum is presumptively invalid under the New Jersey franchise protection act. The court reasoned:

> [O]ur concern is not focused only on the likelihood that the court in the designated forum would properly interpret and apply the Franchise Act, but rather on the denial of a franchisee's right to obtain injunctive and other relief from a New Jersey court. The added expense, inconvenience, and unfamiliarity of litigating claims under the Act in a distant forum could, for some marginally financed franchisees, result in the abandonment of meritorious claims that could have been successfully litigated in a New Jersey court.

Kubis, 146 N.J. at 196, 680 A.2d at 627. Kubis is distinguishable from this case, having dealt with a forum selection clause designating a judicial forum – the question presented here is the validity of a forum selection clause designating an arbitral forum. Federal substantive law governs the enforceability of agreements to arbitrate, and the Supreme Court has resolved this issue against Defendant.

In Southland Corp. v. Keating, 465 U.S. 1 (1983), the Supreme Court reversed the California Supreme Court's holding that claims under the California Franchise Investment were not subject to arbitration pursuant to the parties arbitration agreement. In reversing, the Supreme Court held that the FAA preempted the California act: "In

enacting § 2 of the federal Act, Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration." Id. at 10.[6] "In creating a substantive rule applicable in both state as well as federal courts, Congress intended to foreclose state legislative attempts to undercut the enforceability of arbitration agreements." Id. at 16.[7]

Defendant and DAI agreed to arbitrate all disputes arising under or relating to the franchise

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[6] The Supreme Court explained the distinction between general contract defenses:

We agree, of course, that a party may assert general contract defenses such as fraud to avoid enforcement of an arbitration agreement. We conclude, however, that the defense to arbitration found in the California Franchise Investment Law is not a ground that exists in law or in equity "for the revocation of any contract" but merely a ground that exists for the revocation of arbitration provisions in contracts subject to the California Franchise Investment Law.

Southland, 465 U.S. at 16 n. 11.

[7] See also Saturn Distribution Corp. v. Williams, 905 F.2d 719, 727 (4th Cir. 1990) (Virginia's dealer protection statute "is preempted by the Federal Arbitration Act to the extent that it interferes with the nonnegotiable arbitration provision" in the parties' agreement "requiring the exclusive use of binding arbitration for the determination of dealer contract disputes"); Sweet Dreams Unlimited v. Dial-A-Mattress Intern., 1 F.3d 639, 641 n. 3 (7th Cir. 1993) ("the Supreme Court has held that the Federal Arbitration Act supersedes any state provision that might attempt to insulate certain causes of action from arbitration") (citing Southland Corp. v. Keating, 465 U.S. 1, 10-16 (1984)).

agreement. Defendant may not rely on the New Jersey franchise law to invalidate the parties' arbitration agreement. Defendant is obligated to arbitrate the parties' disputes, including the allegations that DAI violated the New Jersey franchise act.

### *C. Choice of Law Provision*

Defendant alleges that the franchise agreement's designation of Florida law as the law governing the parties relationship is void, unconscionable and unenforceable as against public policy because it conflicts with the New Jersey franchise law. The enforceability of the agreement's choice of law provision does not impact the validity of the arbitration agreement. See Doctor's Associates v. Distajo, 107 F.3d 126, 131 (2d Cir. 1997) ("even the inclusion of a choice-of-law clause does not require application of state law to arbitrability issues"); McCowan v. Sears, Roebuck & Co., 908 F.2d 1099, 1106 (2d Cir. 1990) ("[i]n enacting the Federal Arbitration Act, Congress created national substantive law governing all questions of the validity and enforceability of arbitration agreements within its scope"), cert. denied, 498 U.S. 897 (1990). Defendant is obligated to arbitrate his disputes with DAI regardless of the enforceability of that provision.

### *D. Unconscionability*

Defendant also contends that the arbitration clause is unconscionable and unenforceable to the extent that clause requires Defendant to travel to Connecticut to pursue his New Jersey franchise act

claims and requires the parties to share the costs of the arbitration in Connecticut.[8] Defendant further contends that the financial obligations imposed upon him by arbitration before the AAA violate his right to due process. Defendant fails to cite any authority in support of his due process claim. In support of his unconscionability claim Defendant cites Cole v. Burns Intern. Security Services, 105 F.3d 1465 (D.C. Cir. 1997). The Second Circuit, however, has already addressed this issue. In Doctor's Associates v. Stuart, 85 F.3d 975 (2d Cir. 1996), the court of appeals rejected the claim that the charges involved with presenting disputes before the AAA and the high cost of the Illinois franchisees being forced to arbitrate in Connecticut render the arbitration clause unconscionable and void. Id. at 980-81. Accordingly, this defense is without merit.

### *E. Fraudulent Inducement*

Although not raised in Defendant's opposition papers to DAI's petition to compel, Defendant's fraudulent inducement claims must be resolved initially by the court and is not subject to arbitration. Distajo, 66 F.3d at 457. "[I]f the 'arbitration clause was induced by fraud, there can be no arbitration; and if the party charging this fraud shows there is substance to his charge there must be a judicial trial of that question before a stay can issue.'" Id. (quotation omitted) (emphasis in original). Accordingly, DAI is not entitled to compel arbitration

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[8] Paragraph 10(g) of the agreement provides that "[e]ach party shall be responsible for its own costs including attorney's fees, in any court, mediation or arbitration proceeding."

of Defendant's claims of fraudulent inducement. Since the parties have not briefed whether New Jersey or Florida law applies to Defendant's fraudulent inducement defense or the merits of that defense, that issue cannot be resolved at this time.

## *III. CONCLUSION*

For the foregoing reasons, DAI's petition to compel arbitration [Doc. #1-1] is DENIED WITHOUT PREJUDICE TO RENEW. DAI's motion for a preliminary injunction [Doc #1-2} is DENIED WITHOUT PREJUDICE TO RENEW. The case shall remain open pending resolution of Defendant's fraudulent inducement defense if and when that defense is addressed by the parties.

SO ORDERED.

Dated at New Haven, Connecticut, May 20, 1997.

Peter C. Dorsey /ss/
Peter C. Dorsey
Chief United States District Judge

UNITED STATES DISTRICT COURT
DISTRICT OF CONNECTICUT

| | | |
|---|---|---|
| DOCTOR'S ASSOCIATES, INC., | : | |
| Plaintiff, | : | |
| | : | |
| -vs- | : | Civil No. |
| | : | 3:97cv00459 |
| ERIK J. HAMILTON, | : | (PCD) |
| Defendant. | : | |

**ORDER**

Plaintiff Doctor's Associates, Inc. ("DAI") filed a supplemental brief on June 11, 1997. Since DAI's motion to compel arbitration was denied on May 21, 1997, there is no pending motion to supplement. Presumably, that is the reason Defendant did not file a response. DAI's supplemental brief [doc. #22] will be treated as a renewed motion to compel arbitration. DAI's renewed motion to compel is DENIED.

DAI's initial motion to compel arbitration [doc. #1-1] and motion for a preliminary injunction [doc. #1-2] were denied without prejudice to renew because Defendant's fraudulent inducement claim is not subject to arbitration. Doctor's Associates v. Distajo, 66 F.3d 438, 457 (2d Cir. 1995), cert. denied, 116 S. Ct. 1352 (1996). In DAI's supplemental brief, DAI contends that "Mr. Hamilton alleges that he did not understand the plain meaning and effect of the franchise agreement and/or sublease he signed before he became a franchisee." Supplemental Brief, p. 2. Relying on Doctor's Associates, Inc. v. Stuart, 85 F.3d 975 (2d Cir. 1996), and Doctor's Associates, Inc. v.

Distajo, 107 F.3d 126 (2d Cir. 1997), DAI argues that Defendant's fraudulent inducement claim is without merit.

Defendant's state court complaint does not allege fraudulent inducement based on the terms of the franchise agreement, as in Stuart and Distajo.[1] Instead, Defendant alleges that he was fraudulently induced to enter the franchise agreement based on misrepresentations by DAI and DAI's agents regarding the sales and costs associated with the existing franchise that Defendant purchased. See Complaint and Jury Demand, ¶ 10 (attached as Exhibit C to Petition to Compel Arbitration). Accordingly, Stuart and Distajo are not controlling. Since DAI has not addressed Defendant's allegations of fraud, its renewed motion to compel arbitration/ supplemental brief [doc. #22] is DENIED WITHOUT PREJUDICE TO RENEW.

DAI shall have until August 8, 1997, to file a motion addressing the fraud allegations in Defendant's state court complaint, and Defendant shall have 21 days from that date to file a response. In the absence of such filing, this case will be dismissed since the only issue before the Court is whether to compel arbitration.

SO ORDERED.

---

[1] In both cases, the franchisees claimed that they were fraudulently induced to enter the franchise agreements by DAI's false representations that arbitration was a condition precedent to either party bringing legal proceedings, while in reality DAI had reserved for itself the right to bring eviction proceedings. See Stuart, 85 F.3d at 979; Distajo, 107 F.3d at 134-35.

Dated at New Haven, Connecticut, July 11, 1997.

Peter C. Dorsey /ss/
Peter C. Dorsey
Chief United States District Judge

UNITED STATES DISTRICT COURT
DISTRICT OF CONNECTICUT

| | | |
|---|---|---|
| DOCTOR'S ASSOCIATES, INC., Plaintiff, | : | |
| -vs- | : | Civil No. 3:97cv00459 |
| ERIK J. HAMILTON, Defendant. | : | (PCD) |

**ORDER**

Plaintiff Doctor's Associates, Inc. ("DAI") moved to compel arbitration and to enjoin Defendant Erik J. Hamilton ("Defendant") from prosecuting an action currently pending in the New Jersey state court. Those motions were denied without prejudice to renew on the basis that Defendant had raised a fraudulent inducement claim that had to be resolved initially by the court.

On August 1, 1997, DAI filed a second supplemental brief in support of renewed petition to compel arbitration. Defendant did not file a response to that brief. DAI correctly pointed out in its supplemental brief that Defendant's allegations of fraud in the inducement relate to the franchise agreement as a whole, rather than the arbitration clause. Accordingly, Defendant's fraud in the inducement claim is one properly resolved by the arbitrator. Campaniello Imports, Ltd. v. Saporiti Italia, 117 F.3d 655, 666 (2d Cir. 1997).

Since the remainder of Defendant's defenses to arbitration were previously rejected in the May 21, 1997 Ruling, that Ruling [doc. #21] denying DAI's petition to compel arbitration [doc. #1-1] and motion for an injunction [doc. #1-2] is hereby VACATED. DAI's renewed petition to compel arbitration [doc. #25] is GRANTED. To effectuate the judgment compelling arbitration, Defendant is enjoined from prosecuting the case pending in the Superior Court of New Jersey, Middlesex County, entitled Erik J. Hamilton, et al. v. Doctor's Associates, Inc., et al., Docket No. L-847-97. No bond will be required in the circumstances in this case. The Clerk shall close the file.

SO ORDERED.

Dated at New Haven, Connecticut, September 18, 1997.

Peter C. Dorsey /ss/
Peter C. Dorsey
Chief United States District Judge

FILED
CLERK

No. 98-630

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1998

ERIK J. HAMILTON,

*Petitioner,*

*vs.*

DOCTOR'S ASSOCIATES, INC.,

*Respondent.*

ON PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

## BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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## QUESTIONS PRESENTED

1. Did the Second Circuit correctly hold that, in a federal district court action to compel arbitration pursuant to 9 U.S.C. § 4, subject matter jurisdiction under 28 U.S.C. § 1332 exists where there is complete diversity between the parties and the amount in controversy is not contested?

2. Federal arbitration law preempts state law on the validity and enforceability of an arbitration agreement unless the state law applies to "the revocation of *any* contract," 9 U.S.C. § 2 (emphasis added). Did the Second Circuit correctly hold that if New Jersey's Franchise Practices Act invalidated the forum-selection clause of the parties' arbitration agreement, it would be preempted by Section 2?

## STATEMENT PURSUANT TO RULE 29.6

Doctor's Associates, Inc. has no parent company and no subsidiaries (other than wholly-owned subsidiaries).

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## STATUTORY PROVISIONS INVOLVED

Section 2 of the Federal Arbitration Act, 9 U.S.C. § 2, provides:

> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

Section 4 of the Federal Arbitration Act, 9 U.S.C. § 4, provides, in relevant part:

> A party aggrieved by the alleged failure neglect or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court which, save for such agreement, would have jurisdiction under Title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties, for an order directing that such arbitration proceed in the manner provided for in such agreement. . . .

## STATEMENT OF THE CASE

This is one in a series of appeals to the United States Court of Appeals for the Second Circuit and this Court by certain Subway sandwich shop franchisees seeking to avoid their

contractual obligation to arbitrate their claims against Doctor's Associates, Inc. ("DAI"), the Subway franchisor.[1]

In June 1995, the petitioner here, Erik J. Hamilton, executed a standard franchise agreement with DAI to operate a Subway store in the State of New Jersey. The franchise agreement contains a standard American Arbitration Association ("AAA") arbitration clause, requiring arbitration in Bridgeport, Connecticut, on the demand of either party, of all "disputes arising out of or relating to" the franchise agreement.[2] *See*

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1. Since 1995, petitioner's counsel, representing various Subway franchisees, has unsuccessfully appealed 9 times to the Second Circuit raising numerous reasons why the franchisees he represents should not be required to arbitrate their disputes with DAI. Each time counsel has sought *certiorari*, this Court has denied it. *See, e.g.*, *Doctor's Associates, Inc. v. Hamilton*, 150 F.3d 157 (2d Cir. 1998) (the instant case); *Doctor's Associates, Inc. v. Neal*, Nos. 96-7722, 97-7582 (2d Cir. Feb. 5, 1998); *Doctor's Associates, Inc. v. Riggs*, No. 97-7529 (2d Cir. Feb. 5, 1998); *Doctor's Associates, Inc. v. Hollingsworth*, No. 96-9599 (2d Cir. Feb. 5, 1998); *Doctor's Associates, Inc. v. Riggs*, No. 96-9141 (2d Cir. June 10, 1997), *cert. denied*, 118 S. Ct. 365 (1997); *Doctor's Associates, Inc. v. Distajo*, 107 F.3d 126 (2d Cir.), *cert. denied*, 118 S. Ct. 365 (1997) ("*Distajo II*"); *Doctor's Associates, Inc. v. Jabush*, 89 F.3d 109 (2d Cir. 1996); *Doctor's Associates, Inc. v. Stuart*, 85 F.3d 975 (2d Cir. 1996); *Doctor's Associates, Inc. v. Distajo*, 66 F.3d 438 (2d Cir. 1995), *cert. denied*, 116 S. Ct. 1352 (1996) ("*Distajo I*").

2. The arbitration clause provides as follows:

> Any dispute or claim arising out of or relating to this Agreement not settled by the parties . . . in accordance with the terms of this Agreement is to be submitted directly to arbitration, shall be settled in accordance with the Expedited Procedures of the Commercial Arbitration Rules of the American Arbitration Association at a hearing to be held at Bridgeport, Connecticut. Judgment upon an award rendered

(Cont'd)

*generally*, *Doctor's Associates, Inc. v. Casarotto*, 517 U.S. 681 (1996).

Mr. Hamilton operated his franchise for over a year at a net financial loss. In late 1996, he informed DAI that he believed that his losses were caused by DAI agents whom he believed had fraudulently induced him to enter into his franchise agreement. In light of this dispute, on December 26, 1996, DAI filed with the AAA a demand for arbitration in Bridgeport, seeking "a declaratory judgment that it had not committed fraud and that 'any failure of Hamilton's business and loss of money was entirely Hamilton's responsibility.' " *Hamilton*, 150 F.3d at 159 (brackets omitted). On January 22, 1997, Mr. Hamilton sued DAI and two affiliated individuals in New Jersey Superior Court where he alleged fraudulent inducement of the franchise agreement and violations of the New Jersey Franchise Practices Act. *Id.*

**District of Connecticut Action**. Shortly after Mr. Hamilton filed his lawsuit, DAI filed in the United States District Court for the District of Connecticut a petition, under Section 4 of the Federal Arbitration Act ("FAA"), 9 U.S.C. § 4, to compel arbitration of his claims and a motion to enjoin prosecution of the New Jersey lawsuit pending the arbitration. Because a petition to compel under Section 4 may be brought only in the federal district with jurisdiction over the

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(Cont'd)

> by the Arbitrator may be entered in any court having jurisdiction. The commencement of . . . arbitration proceedings by an aggrieved party to settle any such dispute or claim is a condition precedent to the commencement of legal action by either party, except as specifically provided in this Agreement.

*Hamilton*, 150 F.3d at 159.

contractually designated site of arbitration and because Mr. Hamilton's franchise agreement with DAI calls for arbitration in Bridgeport, the District of Connecticut was the only forum where DAI could properly file its petition. *See, e.g., Maria Victoria Naviera, S.A. v. Cementos Del Valle, S.A.*, 759 F.2d 1027, 1031 (2d Cir. 1985).

Mr. Hamilton opposed DAI's petition and asserted three defenses: (1) because DAI had the right under section 10(d) of the franchise agreement to cap Mr. Hamilton's damages at $50,000, the amount in controversy was insufficient to confer subject matter under 28 U.S.C. § 1332; (2) the arbitration clause's choice of Bridgeport as the forum for arbitration could not be enforced under New Jersey law, the law petitioner argued applied to the franchise agreement, or Florida law, the law specified in the franchise agreement; and (3) the arbitration clause was unconscionable under either New Jersey law or Florida law because it requires Mr. Hamilton to pay half the expenses of arbitration. Significantly, petitioner did not raise one of the defenses that he now asserts as a ground for *certiorari* — that diversity in the Connecticut federal court suit should be determined by reference to the parties in the New Jersey state court rather than the parties before the District Court. Also significantly, petitioner did not question the validity of the arbitration clause and did not argue that DAI or its agents fraudulently induced him to enter into the arbitration clause in the franchise agreement.

Chief Judge Peter C. Dorsey of the Connecticut District Court rejected each of petitioner's defenses and granted DAI's petition to compel arbitration and motion to enjoin Mr. Hamilton from prosecuting the case pending in New Jersey.[3]

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3. Initially, the District Court denied without prejudice to renew DAI's petition to compel and DAI's injunction motion, in the mistaken (Cont'd)

Petitioner's Supplemental Appendix ("Pet. Supp. App.") 31a-32a. Petitioner then appealed to the United States Court of Appeals for the Second Circuit. Petitioner cited four grounds for appeal, two of which are relevant here.

**Jurisdiction Argument.** Petitioner first argued that

> the district court erred in compelling arbitration "because 9 U.S.C. § 4 does not provide a federal statutory cause of action to determine the arbitrability of damage claims pending in a previously filed, non-removable[] state case."

*Hamilton*, 150 F.3d at 161. The Second Circuit noted that petitioner's argument was identical to one that petitioner's counsel had previously raised and lost before the Second Circuit in *Distajo I*, 66 F.3d 438, and to which this Court denied *certiorari* in *Distajo I*, 116 S. Ct. 1352. Relying on *Distajo I*, the Second Circuit held that "the district court had diversity jurisdiction over this action" and that "Hamilton's jurisdictional challenges are without merit." *Hamilton*, 150 F.3d at 161.

**Preemption Argument.** Petitioner also argued that "the district court erred by failing to apply New Jersey law to

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(Cont'd)
belief that Mr. Hamilton had asserted fraudulent inducement of the franchise agreement arbitration clause. If petitioner had made such a claim, Chief Judge Dorsey would have been correct that this was something for the federal District Court and not an arbitrator to decide. *See Prima Paint Corp. v. Flood & Conklin*, 388 U.S. 395, 404 (1967). On June 11, 1997 and on August 1, 1997, DAI filed supplemental briefs, explaining that in the New Jersey action Mr. Hamilton had not alleged fraudulent inducement of the arbitration clause, but rather had only asserted fraud with respect to the entire franchise agreement. The District Court agreed with DAI, and in a September 18, 1997 order granted DAI's petition and motion.

determine the enforceability . . . of the forum selection clause." *Hamilton*, 150 F.3d at 161. Petitioner contended, as he does in his *certiorari* petition, that under New Jersey's franchise law, a forum-selection clause in a franchise agreement that requires arbitration outside the state is void as against public policy and unenforceable. *Id.* at 161-62, *citing Kubis & Perszyk Associates, Inc. v. Sun Microsystems, Inc.*, 680 A.2d 618 (N.J. 1996).[4] Without deciding whether New Jersey franchise law did, in fact, apply to arbitration agreements, the Second Circuit rejected petitioner's claim because "to the extent that [New Jersey's law] can be read to invalidate arbitral forum selection clauses in franchise agreements," Section 2 of the FAA preempts it. *Id.* at 163.

## REASONS FOR DENYING THE PETITION

The Court should deny the Petition for two reasons. First, the Second Circuit correctly applied well-established rules to the particular facts of this case.

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4. Petitioner's *certiorari* papers might also be read to raise a choice of law issue. However, the Second Circuit concluded that Mr. Hamilton had waived any choice of law argument:

> Hamilton, however, argues that the district court failed to consult New Jersey law in deciding whether the arbitration clause was unconscionable. . . . Without reaching the merits of Hamilton's contention, we conclude that he has waived this argument. He failed to bring New Jersey law on unconscionably to the attention of the district court or to argue that section 2 of the Act preserved general principles of state law as rules of decision. Even on appeal, Hamilton cites no New Jersey law undermining the conclusion reached in *Stuart*, nor does he make any argument that New Jersey's standard regarding unconscionably is in any material respect different from the law applied in *Stuart*.

*Hamilton*, 150 F.3d at 163-64, *citing Stuart*, 85 F.3d 975. Because Mr. Hamilton does not challenge the Second Circuit's waiver holding, no choice of law issue remains in the case.

**A.** Petitioner's jurisdiction argument, which the Second Circuit rejected in 1995 and to which this court denied *certiorari* in 1996, is contrary to the language of Section 4 of the FAA, fundamentally at odds with this Court's decision in *Moses H. Cone Memorial Hosp. v. Mercury Construction Corp.*, 460 U.S. 1 (1983), and would completely undermine the efficacy of the FAA.

**B.** Likewise, petitioner's preemption argument offends the clear and broad preemption language of Section 2 of the FAA and this Court's commensurately broad interpretations of that language in *Casarotto*, *Perry*, *Southland* and *Volt*. A more fundamental problem with petitioner's argument, however, is that this Court can reach petitioner's preemption argument only if it assumes that a New Jersey court would invalidate the arbitral forum-selection clause in the parties' franchise agreement. Because the New Jersey courts have not ruled on this issue, at best, this Court would have to hypothesize that New Jersey law prohibits such clauses. At worst, and more likely, petitioner has asked this Court to assume a rule of law that the New Jersey courts are unlikely to adopt.

Second, the Second Circuit's fact-specific decision does not conflict with decisions of this Court or the lower courts and has importance only to the parties. Therefore, it does not present any issue of public importance.

## I.

## THE SECOND CIRCUIT CORRECTLY APPLIED WELL-ESTABLISHED RULES TO THE PARTICULAR FACTS OF THIS CASE

### A. Petitioner's Jurisdiction Argument

The federal diversity jurisdiction statute, 28 U.S.C. § 1332, permits a court to assert diversity jurisdiction where: (1) the amount in controversy exceeds $75,000; and (2) the matter in controversy is between citizens of different states. Petitioner does not dispute the Second Circuit's finding that the amount in controversy exceeds $75,000. *Hamilton*, 150 F.3d at 161. Furthermore, he does not dispute that there is complete diversity between the parties to DAI's District Court Section 4 petition and does not contest the Second Circuit's ruling that the other parties to the New Jersey state court action — who are not parties to the arbitration agreement — are not "indispensable" parties under Rule 19 of the Federal Rules of Civil Procedure. *See id.* Instead, petitioner argues that under Section 4 of the FAA it is the citizenship of the parties to the related state court action, and not the citizenship of the parties to the federal action, that determines subject matter jurisdiction over a petition to compel arbitration.

As the Second Circuit concluded in 1995, petitioner's argument is contrary to the plain language of Section 4 and is without precedent. *Distajo I*, 66 F.3d at 445; *accord Snap-On Tools Corporation v. Mason*, 18 F.3d 1261, 1266-67 (5th Cir. 1994); *Prudential-Bache Sec., Inc. v. Fitch*, 966 F.2d 981, 988 (5th Cir. 1992); *Gibraltar, P.R., Inc. v. Otoki Group, Inc.*, 104 F.3d 616, 618 (4th Cir. 1997). Writing for the Second Circuit, Judge José A. Cabranes held that "[t]he 'parties' to which § 4 of the FAA refers are the parties to the petition to compel."

*Distajo I*, 66 F.3d at 445-46. Section 4 expressly states that the court must have "jurisdiction under Title 28," thereby incorporating the usual rules for determining diversity jurisdiction under Section 1332. 9 U.S.C. § 4. "As with any federal action, diversity of citizenship is determined by reference to the parties named in the proceeding before the district court." *Distajo I*, 66 F.3d at 445.

According to petitioner, the Second Circuit's straightforward, plain language interpretation of Section 4 would impermissibly allow a petitioner under Section 4 to "accomplish something prohibited by 9 U.S.C. § 3 — the use of one court to stay damage claims pending in another court." Petition ("Pet.") 11. This argument is meritless. Section 3 does not "prohibit" one court from staying an action in another court pending arbitration. Only "the court in which [an arbitrable] suit is pending" can hear a petition under Section 3. 9 U.S.C. § 3. On the other hand, only an "United States district court" that "would have jurisdiction under Title 28 for an order directing . . . arbitration" can hear a petition under Section 4. 9 U.S.C. § 4. Sections 3 and 4 serve different purposes, are entirely compatible, and DAI properly invoked the latter. Petitioner has not identified any language in the text of the FAA or its legislative history that even remotely suggests that Congress intended that diversity of citizenship in a Section 4 action should be determined by the citizenship of parties to a separate state court action.

In addition, petitioner's assertion squarely conflicts with this Court's decision in *Moses H. Cone*, *supra*, which held that

> under the [FAA], an arbitration agreement must be enforced notwithstanding the presence of other persons who are parties to the underlying dispute but not to the arbitration agreement.

*Moses H. Cone*, 460 U.S. at 20, *cited in Distajo I*, 66 F.3d at 446. If petitioner were correct, *Moses H. Cone* would never have been decided since, as here, that case — a Section 4 action in federal court — originally arose out of a parallel state court litigation involving non-diverse parties. *Moses H. Cone*, 460 U.S. at 7 n.4.

Finally, the flaws in petitioner's position are also underscored by the practical effect that his interpretation of Section 4 would have on the ability of parties to compel arbitration under the FAA. If petitioner were correct, a corporation doing business nationwide rarely would be able to bring an action in federal court to compel arbitration with a diverse party. If a federal court were required to determine diversity according to the parties sued in a state court case, the District Court, as a practical matter, could never exercise jurisdiction over a Section 4 petition, because "a party resisting arbitration could defeat federal jurisdiction simply by suing someone from the same state, plus the party seeking to compel arbitration, in a separate state lawsuit." *Distajo I*, 66 F.3d at 445. Petitioner's interpretation would thus eviscerate the rights granted by Section 4, because the statute, on its face, provides that petitions to compel can only be brought in federal court, and only in the district where the arbitration will occur. *Distajo I*, 66 F.3d at 445-46; *see also Snyder v. Smith*, 736 F.2d 409, 420 (7th Cir.), *cert. denied*, 469 U.S. 1037 (1984); *Aaacon Auto Transport, Inc. v. Ninfo*, 490 F.2d 83, 84 (2d Cir. 1974); *National Iranian Oil Co. v. Ashland Oil, Inc.*, 641 F. Supp. 211, 213 (S.D. Miss. 1986), *aff'd*, 817 F.2d 326 (5th Cir. 1987), *cert. denied*, 484 U.S. 943 (1987).

## B. Petitioner's Preemption Argument

### 1. *Petitioner asks this Court to hypothesize a new rule of New Jersey law.*

This Court could only reach petitioner's second ground for *certiorari* — that the Second Circuit erred in finding that Section 2 of the FAA preempts New Jersey franchise law "to the extent that [it] can be read to invalidate arbitral forum selection clauses in franchise agreements" — if it assumed that the arbitral forum selection clause in the parties' franchise agreement would indeed be invalid under New Jersey franchise law. *Hamilton*, 150 F.3d at 163. This is a valid assumption, petitioner argues, based on the Supreme Court of New Jersey's ruling in *Kubis & Perszyk Associates, Inc. v. Sun Microsystems, Inc.*, 680 A.2d 618 (N.J. 1996).

*Kubis*, however, stands for the principle that *judicial* forum-selection clauses in franchise agreements are presumptively invalid. As the District Court below recognized, the *Kubis* court never held or even indicated whether this principle would be extended to the *arbitral* forum-selection context. Pet. Supp. App. 22a-24a. At best, therefore, petitioner asks this Court to hypothesize that the Supreme Court of New Jersey would, if faced with the franchise agreement here, extend the rule of *Kubis* into the arbitration context.

At worst — and more likely — petitioner asks this Court to hypothesize a New Jersey rule of law that the Supreme Court of New Jersey would not, and will never, adopt. The *Kubis* court found that in enacting the Franchise Practices Act ("FPA") the New Jersey legislature had intended to "protect[] franchisees from the superior bargaining power of franchisors and provide[] *swift and effective judicial relief* against franchisors that violate the [FPA]." *Kubis*, 680 A.2d at 626 (emphasis added). To enforce forum-selection clauses, the New Jersey Supreme Court held,

> would be to limit severely the availability of *New Jersey courts* as a forum for the enforcement of franchisees' claims under the [FPA], a result that the Legislature assuredly would find intolerable.

*Id.* at 628 (emphasis added).

Arbitral forum-selection agreements, however, do not raise the ills that the *Kubis* court sought to redress by creating a presumption against litigation forum-selection agreements. If the District of Connecticut were to order arbitration in New Jersey (as petitioner wants) instead of Connecticut (as designated by the parties in their franchise agreement), it would not rectify what the New Jersey legislature "would find intolerable": petitioner would still be denied the right to obtain injunctive and other relief from a New Jersey court. Because the legislative policy that *Kubis* sought to give effect by holding invalid judicial forum-selection clauses does not militate toward holding invalid arbitral forum-selection clauses, there is every reason to assume that the Supreme Court of New Jersey would not, and will not, adopt petitioner's expansion of *Kubis*.[5] Petitioner's injury, therefore, is purely hypothetical, and this case is thus an inappropriate vehicle for addressing the preemption issue that petitioner raises.

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5. What the *Kubis* court found offensive about judicial forum-selection clauses — that such clauses keep New Jersey franchisees out of the New Jersey state courts — may perhaps militate towards the invalidation of arbitration clauses (as opposed to arbitral forum-selection clauses) in New Jersey franchise agreements. However, any such holding by the Supreme Court of New Jersey would clearly be preempted by Section 2 and there is no reason to suppose that the New Jersey Supreme Court will construe its law in a manner that is clearly violative of the FAA. *See Southland Corp. v. Keating*, 465 U.S. 1, 26 n.11 (1984) (Section 2 preempts state law rule that invalidates arbitration clauses in franchise contracts).

2. *Petitioner's preemption argument ignores the clear and broad language of Section 2.*

Even if petitioner were correct in his interpretation of the *Kubis* rule — and he is not — the Second Circuit correctly held that to the extent that the FPA can be read to invalidate arbitral forum-selection clauses, the law would be preempted. The scope of Section 2 preemption is broad:

> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

9 U.S.C. § 2; *see Securities Industry Ass'n v. Connolly*, 883 F.2d 1114, 1118 (1st Cir. 1989), *cert. denied*, 495 U.S. 956 (1990) (Section 2 "sweeps broadly and brooks little reservation").[6]

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6. The Supremacy Clause of Article VI of the federal Constitution prevents the states from impinging on federal law and policy. *See Louisiana Pub. Serv. Comm'n v. FCC*, 476 U.S. 355, 368 (1986). Preemption — the vehicle by which the Supremacy Clause is generally enforced — always boils down to a matter of congressional intent. *Schneidewind v. ANR Pipeline Co.*, 485 U.S. 293 (1988); *California Fed. Sav. & Loan Ass'n v. Guerra*, 479 U.S. 272, 280 (1987). Interpretation of a statute's intent must start with the text itself, *United States v. James*, 478 U.S. 597, 604 (1986), and that language chosen by Congress must be accorded its ordinary meaning, *American Tobacco Co. v. Patterson*, 456 U.S. 63, 68 (1982).

As this Court stressed in *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University*, 489 U.S. 468, 478 (1989), neither state legislatures nor courts are free to pick and chose which portions of an arbitration agreement to enforce, because "Congress' principal purpose" in passing the FAA was "ensuring that private arbitration agreements are enforced according to their terms." 489 U.S. at 478. No fewer than five times in the last two pages of his *Volt* majority opinion, Chief Justice Rehnquist reiterated that the FAA "requires courts to enforce . . . agreements to arbitrate, like other contracts, in accordance with their terms." *Id. Volt* emphasized that

> [a]rbitration under [the FAA] is a matter of consent, not coercion, and parties are generally free to structure their arbitration agreements as they see fit. Just as they may limit by contract the issues which they will arbitrate, so too may they specify by contract *the rules under which that arbitration will be conducted.*

*Id.* (emphasis added). The same is true when the contract designates the arbitration site, which then becomes a crucial feature of the arbitration procedure to which the parties have agreed.[7]

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7. That is why federal courts have consistently held that the FAA requires enforcement of arbitral forum-selection clauses, as written. *See, e.g., Roney & Company v. Goren*, 875 F.2d 1218, 1221 (6th Cir. 1989); *Snyder*, 736 F.2d at 419; *USM Corp. v. GKN Fasteners, Ltd.*, 574 F.2d 17, 20 (1st Cir. 1978); *Sam Reisfeld & Son Import Co. v. S.A. Eteco*, 530 F.2d 679, 680-81 (5th Cir. 1976); *Medika Int'l, Inc. v. Scanlan Int'l, Inc.*, 830 F. Supp. 81, 86 (D.P.R. 1993); *Al-Salamah Arabian Agencies Co., Ltd. v. Reece*, 673 F. Supp. 748, 751 (M.D.N.C. 1987); *Spring Hope Rockwool, Inc. v. Industrial Clean Air, Inc.*, 504 F. Supp. 1385, 1389 (E.D.N.C. 1981); *Haluska v. RAF Financial Corporation*, 875 F. Supp. 825, 828-29 (N.D. Ga. 1994).

*Volt* did not involve FAA § 4, but the refrain that parties must get the particular type or arbitration called for in their contract is entirely consistent with the plain language of that section, which contemplates a court "order directing that . . . the arbitration proceed *in the manner provided for*" in the arbitration agreement. 9 U.S.C. § 4 (emphasis added). Here, that requires arbitration at the location agreed to by the parties.

To avoid full enforcement of the arbitration agreement in accordance with its terms, petitioner must find refuge in the last clause of FAA § 2, which provides that arbitration agreements subject to the FAA "shall be valid, irrevocable, and enforceable, *save upon such grounds as exist at law or in equity for the revocation of any contract.*" 9 U.S.C. § 2 (emphasis added). However, extending *Kubis* to arbitral forum-selection clauses would not fit within this exception to Section 2's broad policy of enforcing arbitration agreements in accordance with their terms.

As the Supreme Court has repeatedly declared, the FAA preempts all state laws that single out and impermissibly burden arbitration agreements. In *Southland*, 465 U.S. at 11, the Court held that the FAA adopted a "broad principle of enforceability" of arbitration agreements, with the only exceptions those identified in § 2 — grounds for revocation that would apply to "any contract." A footnote in *Perry v. Thomas*, 482 U.S. 483 (1987), made the same point in even stronger language. There, after refusing to consider (because it was not raised below) the appellants' claim that the arbitration agreement was "an unconscionable, unenforceable contract of adhesion," Justice Marshall observed:

> In instances such as these, the text of § 2 provides the touchstone for choosing between state-law principles and the principles of federal common law

> envisioned by the passage of that statute: An agreement to arbitrate is valid, irrevocable and enforceable, *as a matter of federal law, see Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 24 (1983), "save upon such grounds as exist at law or in equity for the revocation of *any* contract." 9 U.S.C. § 2. Thus state law, whether of legislative or judicial origin, is applicable *if* that law arose to govern issues concerning the validity, revocability and enforceability of contracts generally.

482 U.S. at 492-93 n.9 (emphasis in original).

Similarly, *Volt*, citing *Perry*, declared that "*general* state-law principles of contract interpretation" apply to "the interpretation of an arbitration agreement within the scope of the Act." 489 U.S. at 475 (emphasis added). And in *Casarotto*, the *Perry* footnote became the centerpiece of the Court's analysis of an arbitration agreement virtually identical to the one at issue in this Petition. Justice Ginsberg twice repeated "our observation in *Perry*" that, under the plain language of FAA Section 2, state law "may be applied" to invalidate an arbitration agreement *only if* " 'that law arose to govern issues concerning the validity, revocability and enforceability of contracts generally.' " 517 U.S. at 686-87 (citation omitted). Only "*generally applicable contract defenses*, such as fraud, duress or unconscionability, may be applied to invalidate arbitration agreements without contravening § 2." *Id.* at 687 (emphasis added).

As Judge Meskill recognized, petitioner's interpretation of the New Jersey Franchise Practices Act does not establish a generally applicable contract defense. His view of New Jersey law would restrict enforcement of just one sort of provision —

forum selection provisions — in only one type of contract — a franchise agreement. Under *Casarotto*, *Perry*, *Southland* and *Volt*, such a provision would clearly fall outside the savings clause of FAA § 2. *See Casarotto*, 517 U.S. at 686-88; *Perry*, 482 U.S. at 492-93 n.9; *Volt*, 489 U.S. at 475; *Southland*, 465 U.S. at 11; *see also Management Recruiters International, Inc. v. Bloor*, 129 F.3d 851, 856 (6th Cir. 1997) (if the Washington Franchise Act "imposed an absolute requirement of in-state arbitration notwithstanding the parties' agreement to arbitrate [elsewhere], its validity would be in serious doubt as a result of the preemptive effect of the FAA"); *Saturn Distribution Corp. v. Williams*, 905 F.2d 719 (4th Cir. 1990) (FAA Section 2 preempts state rules of contract formation which single out arbitration clauses); *Connolly*, 883 F.2d 1114 (states cannot circuitously restrict arbitration clauses by imposing penalties on their enforcement in violation of the FAA); *see also* Edward Wood Dunham, *et al.*, *Franchisor Attempts to Control the Dispute Resolution Forum: Why the Federal Arbitration Act Trumps the New Jersey Supreme Court's Decision in Kubis*, 29 RUTGERS L. J. 237 (Winter 1998).

Because the Second Circuit correctly applied well-established principles to the particular facts of this case, there is no reason for this Court to grant *certiorari* to review that decision.

## II.

## THE SECOND CIRCUIT'S FACT-BOUND DECISION DOES NOT CONFLICT WITH ANY OTHER DECISION AND DOES NOT WARRANT REVIEW

This Court has consistently stated that writs of *certiorari* will not issue "except in cases involving principles the settlement of which is of importance to the public, as

distinguished from [] the parties. . . ." *Layne & Bowler Corp. v. Western Well Works*, 261 U.S. 387, 393 (1923); *see Rice v. Sioux City Cemetery*, 349 U.S. 70, 79 (1955). The Court has also repeatedly stated that other than in exceptional circumstances not presented here, it will not review fact-specific determinations by the lower courts. *United States v. Johnston*, 268 U.S. 220, 227 (1925) (court will not review evidence or factual findings); *Graver Mfg. Co. v. Linde Co.*, 336 U.S. 271, 275 (1949) (court will not review findings of fact without exceptional show of error).

Here, the Second Circuit applied well-established legal principles to the unique facts of this case. With respect to petitioner's jurisdiction argument, the Second Circuit found petitioner's argument "without merit" on a straightforward application to the facts of the rule of *Distajo I*, 66 F.3d at 445. *Hamilton*, 150 F.3d at 161. With respect to petitioner's Section 2 preemption argument, the Second Circuit simply applied "the clear language of *Southland* [465 U.S. 1]" to the facts. *Id.* at 163. As shown above, the Second Circuit's decision does not conflict with the decisions of this Court.

More important, petitioner does not even claim that the decision conflicts with decisions of any other court. And for good reason. The Second Circuit's decision on both jurisdiction and preemption is fully in accord with decisions of other federal courts of appeal. *See, e.g., Mason*, 18 F.3d at 1266-67 (jurisdiction); *Fitch*, 966 F.2d at 988 (jurisdiction); *Gibraltar*, 104 F.3d at 618 (jurisdiction); *Bloor*, 129 F.3d at 856 (preemption); *see also* cases in n.7, *supra* (preemption).

The Second Circuit's fact-specific and correctly decided decision has importance only to the parties and does not present any issue of public importance. It does not warrant this Court's review.

## CONCLUSION

For the foregoing reasons, respondent respectfully requests that the Court deny petitioner's petition for *certiorari*.

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No. 98-630

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1998

ERIK J. HAMILTON,

Petitioner,

vs.

DOCTOR'S ASSOCIATES, INC.,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

# REPLY TO BRIEF IN OPPOSITION

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## QUESTIONS PRESENTED

I. Whether the Federal Arbitration Act preempts general state contract law principles, applicable to all contracts, when an arbitration clause is included.

II. Whether the Federal Arbitration Act authorizes United States districts courts to compel arbitration of damage claims pending in previously filed, non-removable, state cases.

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No. 98-630

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IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1998

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ERIC J. HAMILTON

Petitioner,

vs.

DOCTOR'S ASSOCIATES, INC.,

Respondent.

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# REPLY TO BRIEF IN OPPOSITION

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## ARGUMENT

### I. Certiorari is required to distinguish the issues governed by federal policy from those governed by general state contract law principles.

Doctor's Associates, Inc. ("DAI") argues that Section 2 of the FAA (9 U.S.C. §2) preempts all state law contract principles affecting the validity and enforceability of arbitration clauses except state contract principles that apply to all contracts and not

state contract law principles that apply to all contracts of a specified kind, such as franchise contracts, consumer contracts, employment contracts, etc., relying upon Management Recruiters International, Inc. v. Bloor, 129 F.3d 851 (6th Cir. 1997), a Rutgers Law Journal article written by the attorneys for DAI and the decision below, Doctor's Associates, Inc. v. Hamilton, 150 F.3d 157 (2d Cir. 1998). (Brief in Opposition, pp. 8, 11, 13, 17). DAI argues that the FAA trumps the New Jersey Supreme Court's decision in Kubis & Perszyk Associates, Inc. v. Sun Microsystems, Inc., 680 A.2d 618 (N.J. 1996). (Brief in Opposition p. 17).

Petitioner, however, contends that New Jersey State contract law principles voiding choice of law and choice of forum selection clauses in New Jersey franchise contracts, applicable to both out-of-state litigation and arbitration, is not preempted by the Federal Arbitration Act.

This issue has not previously been addressed by this Court and the lowers courts are in conflict. In Doctor's Associates, Inc. v. Hamilton, 150 F.3d 157 (2d Cir. 1998), the court held that the role played by state law in FAA jurisprudence is so narrow that it was not necessary to determine which state law applied. (Appendix at pp. 10a, 14a). The Second Circuit also holds that "*** even the inclusion in the contract of a general choice-of-law clause does not require application of state law to arbitrability issues, unless it is clear that the parties intended state arbitration law to apply on a particular issue. Doctor's Associates, Inc. v. Distajo, et al., 107 F.3d 126, 130-31 (2d Cir. 1997).

In Charles S. Barker, et al. v. Golf U.S.A., Inc., 154 F.3d 788, 792 (8th Cir. 1998), the court elevated state law to the extent that it was applied to reject the federal separability doctrine established by Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395, 18 L. Ed. 2d 1270 (1967). The franchisees in the Charles S. Barker case filed a petition for a writ of certiorari to this Court, now pending as case No. 98-644.

Both DAI and the Second Circuit opinion below rely upon Management Recruiters Intern., Inc. v. Bloor, 129 F.3d 851, 855 (6th Cir. 1997). (Appendix, p. 12a; Brief in Opposition at p. 17, 18.) Management Recruiters Intern., Inc. v. Bloor, however, applied Washington state law to determine whether the Washington Franchise Investment Protection Act ("FIPA") prohibited choice of forum clauses requiring arbitration outside the State of Washington, finding that it did not. The court then proceeded to note in passing that if the Washington Franchise Act had prohibited out-of-state arbitration, its validity would be in serious doubt. Id. 856.

In the case at bar, however, New Jersey law clearly prohibits forum selection clauses requiring litigation outside the State of New Jersey for New Jersey franchisees operating franchise shops within New Jersey. Kubis & Perszyk Associates, Inc. v. Sun Microsystems, Inc., 680 A.2d 618 (N.J. 1996). It is submitted here that the New Jersey Supreme Court would clearly hold that forum selection clauses under the circumstance of this case requiring either litigation or arbitration outside of New Jersey are

void and unenforceable as conflicting with the public policy behind the New Jersey Franchise Act, N.J.S.A. 56:10-1 through 56:10 -15. See also Instructional Systems, Inc. v. Computer Curriculum Corp., 130 N.J. 323, 614 A.2d 124 (1992). The rationale behind the New Jersey Supreme Court's decision voiding litigation forum selection clauses leaves no doubt that it would arrive at the same conclusion about arbitral forum selection clauses. Kubis & Perszyk Associates, Inc. v. Sun Microsystems, Inc., 680 A.2d 618, 626, 627 (N.J. 1996); "We hold that such clauses are presumptively invalid because they fundamentally conflict with the basic legislative objectives of protecting franchisees from the superior bargaining power of franchisors and providing swift and effective judicial relief against franchisors that violate the Act.

A significant difference exists between the function of a forum-selection clause in an arms-length commercial contract and its function in a typical contract subject to the Franchise Act. ***

*** Although such a clause directly benefits the franchisor by requiring suit to be filed in a geographically convenient state of choice where it can be defended by the franchisor's regular litigation counsel, the indirect benefit to franchisors is to make litigation more costly and cumbersome for economically weaker franchisees that often lack the sophistication and resources to litigate effectively a long distance from home. *** Thus, if unchallenged by the franchisee, a forum-selection clause can materially diminish the rights guaranteed by the Franchise Act because the franchisee must assert those rights in an unfamiliar and distant forum, with

out-of-state counsel, and bear the added expense of litigation in the franchisor's designated forum."

Petitioner respectfully submits that, if permitted, the New Jersey courts would also have determined that the arbitration clause is void and unenforceable as unconscionable and against public policy for the reasons expressed in the Kubis v. Perszyk Associates, Inc. and Instructional Systems, Inc. v. Computer Curriculum Corp. cases. The American Arbitration Association requires payment of all fees and charges by both parties before permitting its arbitrators to issue an award. Erik Hamilton has insufficient funds to pay the approximately $20,000.00 required to obtain issuance of an arbitration award, if he were arbitrating in New Jersey, much less the approximately $32,000.00 that would be required for fees and expenses if he were required to arbitrate in Connecticut. Moreover, while requiring the franchisees to arbitrate their claims in Connecticut, DAI reserves the right to litigate its claims in the form of eviction actions filed by its alter ego, assetless leasing companies, which lease Subway sandwich shop locations from the landlords and sub-lease them to the franchisees. The sub-leases contain a cross-default clause making any breach of the franchise agreement by the franchisee, sub-lessee a breach of the sub-lease. The threat of eviction exposes the franchisee to the potential loss of his entire investment. Only the franchisees are required to arbitrate. The franchisor reserves the right to litigate. See Doctor's Associates, Inc. v. Distajo, et al., 66 F.3d 438 (2d Cir. 1995), cert. denied, 116 S. Ct. 1352 (1996); Doctor's Associates, Inc. v. Distajo, et al., 107 F.3d 126 (2d Cir. 1997), cert. denied, 118 S. Ct.

365 (1997); Yates v. Doctor's Associates, Inc., 549 N.E.2d 1010, 140 Ill. Dec. 359 (Ill. App. 1990); Cox v. Doctor's Associates, Inc., 613 N.E.2d 1306, 184 Ill. Dec. 714 (Ill. App. 1993), appeal denied, 622 N.E.2d 1202 (Ill. 1993), cert. denied, 510 U.S. 1118 (1994); Subway Restaurants, Inc., et al. v. Riggs, 696 N.E.2d 733, 231 Ill. Dec. 437 (Ill. App. 1998); Jannotta v. Doctor's Associates, Inc., 125 F.3d 503 (7th Cir. 1997).

While DAI argues that Erik Hamilton's position requires this Court to determine how the New Jersey Supreme Court would rule when faced with an arbitral forum selection clause, instead of a litigation forum selection clause, it should be noted that DAI precluded the New Jersey courts from determining this issue of New Jersey law by requesting and obtaining the Connecticut federal injunction barring the New Jersey state courts from determining the enforceability and validity of the arbitration clause.

The attorneys for DAI acknowledge that the law is unclear on this question. See Edward Wood Dunham, "Franchisor Attempts to Control the Dispute Resolution Forum: Why the Federal Arbitration Act Trumps the New Jersey Supreme Court's Decision in Kubis," 29 RUTGERS L.J. 237, 261 (Winter 1998). "*** A more difficult question arises when state law singles out a number of subjects, including arbitration, for special treatment. At what point, if ever, will there be enough other subjects so that the special treatment is considered part of the general law of the state? *** However, while it is probably true that 'at the present time the boundary of § 2's savings clause is unclear, these state

laws and judicial decisions are clearly on the wrong side of the line."

Petitioner respectfully submits that the decision below, holding that the FAA preempts general state law principles, applicable to all franchise contracts, with or without arbitration clauses, requiring litigation and/or arbitration within New Jersey under New Jersey law is on the wrong side of the line. Congress did not clearly intend for the FAA to override general state substantive laws applicable to specified types of contracts, such as franchise agreements, consumer contracts, employment contracts, etc.

Certiorari is required to clarify the limits of federal preemption under the FAA. Did Congress intend for the FAA to preempt general state contract law principles, applicable to all contracts of a specified type, which do not discriminate against arbitration clauses? There is a general presumption against preemption unless that was the clear and manifest purpose of Congress. Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230 (1947); Maryland v. Louisiana, 451 U.S. 725, 746 (1981); Cipollone v. Liggett Group, Inc., 112 S. Ct. 2608, 2617-18 (1992).

## II. Petitioner's "lack of statutory authority" argument assumes, and does not challenge, federal diversity jurisdiction.

The court below concluded that Erik Hamilton's "absence of statutory authority" argument was a challenge to diversity jurisdiction. Doctor's Associates, Inc. v. Hamilton, 150 F.3d 157 (2d Cir.

1998); Appendix, p. 8a, 9a. DAI makes the same argument here. (Brief in Opposition, pp. 8-10). Yet Petitioner has repeatedly stated the issue as assuming the existence of federal diversity jurisdiction, and challenging the statutory authority under 9 U.S.C. §§ 3, 4 for a federal court, with diversity jurisdiction, to compel arbitration of damage claims pending in a previously-filed, non-removable state case. (Appendix, p. 8a; Petition for a Writ of Certiorari, pp. 10-15).

The issue raised here was not presented in Moses H. Cone Memorial Hospital v. Mercury Construction Corp., 460 U.S. 1 (1983) which concerned a prior non-removable state action for a declaratory judgment, not for damages, and did not involve a federal injunction against further prosecution of the state action. The decision below permits DAI to use Section 4 of the FAA and a federal injunction to accomplish something prohibited by Section 3 of the FAA, the use of one court to compel arbitration and stay litigation of damage claims pending in another court. After enjoining the New Jersey state court from determining the validity and enforceability of the arbitration clause, DAI complains to this Court that Erik Hamilton is asking it to determine an issue of New Jersey state law. The parties would have New Jersey's position on this issue by now but for the Connecticut federal injunction issued at the request of DAI.

Erik Hamilton submits that the validity and enforceability of the arbitration clause under New Jersey state law should be determined by the New Jersey state court in the pending New Jersey action

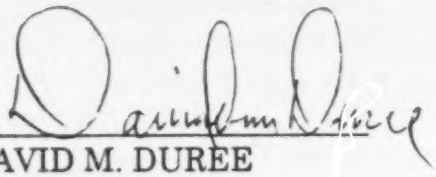
because 9 U.S.C. § 4 did not authorize the Connecticut federal court to compel arbitration of the damage claims pending in the previously-filed New Jersey state action. DAI has developed a technique which provides, in essence, federal jurisdiction of petitions to compel arbitration under 9 U.S.C. § 4 in almost every case by filing a federal action between two diverse parties in a prior pending, multi-party, state action followed by a federal injunction against the entire state action. If Congress had intended to provide federal jurisdiction of petitions to compel arbitration under Section 4 of almost all prior pending, non-removable, state damage claims, it simply would have provided independent federal jurisdiction for actions under 9 U.S.C. § 4. It did not do so because it did not intend for the FAA to enlarge federal jurisdiction.

Petitions to compel arbitration and to stay litigation of previously filed state damage claims should be filed in the state courts under the substantive parts of the FAA (§§ 1 and 2) and state procedural rules, which do not require that petitions to compel be filed in the geographical locations where arbitration is to occur.

## CONCLUSION

For the reasons stated, the Petition for a Writ of Certiorari should be granted.

Respectfully submitted,



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